The Montana Court has not singled out arbitration in the application of the fiduciary duty of full disclosure. Indeed in the case of *Murphy v. Redland*, 178 Mont. 296, 583 P.2d 1049 (1978) the Montana Court applied the same fiduciary duty definition used in *Willems* to deny a joint adventurer (Redland) the right to recover damages from his fellow joint adventurer (Murphy) when the damage was caused by Redland's failure to disclose a cattle sale. Similarly, in *Deist v. Wacholz*, 208 Mont. 207, 678 P.2d 188 (1984), the Montana Court found a special relationship between a bank officer and a bank customer which gave rise to a fiduciary duty on behalf of the bank officer to disclose his involvement in the purchase of a ranch.

Further evidence that the Montana Court does not "single out" arbitration in the application of its fiduciary duty law can be found in the case of *Chor, supra*. In *Chor*, the Montana Court held that "in the absence of discretionary authority by a stockbroker to buy and sell in a customer's account, no fiduciary relationship is created in a broker-customer relationship". *Chor*, 261 Mont. at 152, 86 P.2d at 31-32. Because the *Chor* Court found in that case that no such "discretionary authority" existed it did not hold Piper's broker to any fiduciary duty and it enforced the arbitration provision.

In the case at issue herein, the Montana court (based on the *Willems* analysis), having found that Piper had retained "discretionary authority," applied the well-established rules concerning the duties of a fiduciary to disclose relevant information about the relationship. Here, Piper had an internal policy that allowed investors to "opt out" of the arbitration requirement by simply crossing out the arbitration provision. This policy is not a written part of the agreement. In fact, it is quite unique in the securities

industry. In each of the cases currently before this Court, it was undisputed that Piper failed to disclose its policy of allowing customers to "opt-out" of arbitration by crossing out the provision in the contract. The Montana court simply held that, under these unique circumstances, Piper, as a fiduciary, owed its investor clients the duty to disclose the consequences of the arbitration provision and this "opt out" information. *Willems, supra*, ¶¶ 23, 25 (App. 46-47). Such a duty arises from state law dealing with fiduciaries and would apply to all contracts whether dealing with arbitration or not. Thus, the Montana Court in *Willems* did nothing more than require such disclosure based upon the fiduciary relationship which was formed by Piper's own form agreement. Application of this fiduciary duty is therefore consistent with the FAA and as such the issuing of a Writ of Certiorari is not warranted.

State courts have issued thousands of decisions dealing with the nature and scope of a fiduciary duty. Many state courts, just like the Montana state court, quote Justice Cardozo in the case of *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928),[6] who explained the nature of the fiduciary duty as follows:

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[6] *Kloss v. Edward D. Jones & Co.*, 2002 MT 129, ¶ 37, 54 P.3d 1, 9, ¶ 37, 310 Mont. 123, 135, ¶ 37. The following is a sample of the state court decisions which relied on the *Meinhard* decision in analyzing the scope of fiduciary obligations: *Lindsay v. Marcus*, 137 Colo. 336, 325 P.2d 267, (1958 Colo); *Brown v. Halbert*, Division Three, 271 Cal. App. 2d 252, 76 Ca.Rptr. 781 (1969 Cal.App.); *In re Evans*, 113 Ariz. 458, 556 P.2d 792, (1976 Arz.); *Ditis v. Ahlvin Const. Co.*, 408 Ill. 416, 97 N.E.2d 244, (1951 Ill.); *Amoco Prod. Co. v. Charles B. Wilson, Jr. Inc.*, 266 Kan. 1084; 976 P.2d 941, (1999 Kan.); *Appeal of Concerned Corporators of Portsmouth Sav. Bank*, 129 N.H. 183; 525 A.2d 671, (1987 N.H.); *Silverman v. Bresnahan*, 35 N.J. Super. 390; 114 A.2d 307 (1955 N.J.); *Young v. Field*, 548 So.2d 784, (1989 Fla.); *Van Stee v. Ransford*, 346

(Continued on following page)

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher then that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

Id. at 464, 164 N.E. at 546.

Central in most cases dealing with a fiduciary's duties is the idea that a fiduciary must fully disclose all relevant matters concerning its dealings. (See Footnote 5, *supra.*) Montana's court, like every state court, employs its fiduciary duty law routinely to decline to enforce contracts when there has been a lack of disclosure. *See, e.g., Deist*, 208 Mont. at 228, 678 P.2d at 198; *Watson*, 239 Mont. at 368, 782 P.2d at 363. Contrary to Piper's suggestion, the Montana court's decisions at issue herein do not conflict in any way with the decisions of the appellate courts of other states. The cases cited by Piper have nothing to do with the fiduciary duty which formed the basis of the Montana court's decision. Moreover, in that the laws relating to fiduciary duty and contract formation are the province of

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Mich. 116, 77 N.W.2d 346 (1956 Mich.); *Ellezy v. Fyr-Pruf, Inc.*, 376 So. 2d 1328, (1979 Miss.).

the states, any potential conflicts among the laws of such states relating to fiduciary duty and contract formation and revocation constitute permissible differences of opinion. *Ruhlin v. New York Life Ins. Co.*, 304 U.S. 202, 206 (1938).

Pursuant to Supreme Court Rule 10, a review on a writ of certiorari is not a matter of right but of judicial discretion and will be granted only for "compelling reasons." No compelling reasons exist for this Court to review the unpublished decision of the Montana court at issue herein. This is particularly true since it has already declined to review the previous decisions involved in the *Shea* Petition for Certiorari. Further no substantial federal questions are presented. Nor does an impermissible conflict among the state courts of last resort exist as to any federal question. Both the FAA and Montana's statutory law [§ 27-5-114(2) MCA (2003)] provide that arbitration agreements are valid "except where grounds exist at law or in equity to revoke the contract." Here, citing Section 2 of the FAA, the Montana court declined to enforce the arbitration provision in question based upon the well established Montana law concerning fiduciary obligations that it applies to all such contracts, not just contracts involving arbitration. For these reasons, the Montana court correctly considered and applied the Federal Arbitration Act law in connection with the unique facts of these cases, including those concerning Piper's "opt-out" policy which gave rise to a fiduciary duty to explain an existence and terms to a client. Given that the Montana court's analysis and application of state law generally governing contract formation is not in conflict

with the FAA,[7] this Court should not review this matter on a writ of certiorari.

CONCLUSION

For the foregoing reasons, Respondents respectfully request this Court to deny Petitioner's Writ of Certiorari.

Respectfully submitted,

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[7] At most, Piper has alleged the misapplication by the Montana court of a properly stated rule of law, a situation which this Court, pursuant to Supreme Court Rule 10, has concluded does not constitute the requisite "compelling reason" for granting a petition for certiorari.

No. 05-745

Supreme Court, U.S.
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In The Supreme Court of the United States

PIPER JAFFRAY & CO., et al.,

Petitioners,

v.

RAYMOND KAUFMAN, Individually and as Trustee of the MONTANA FACIAL SURGERY PENSION AND PROFIT PLAN and JANET L. NOTHSTINE,

Respondents.

On Petition For Writ Of Certiorari To The Montana Supreme Court

REPLY TO BRIEF IN OPPOSITION

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTRODUCTION 1

I. The Montana Supreme Court addressed a federal question 2

II. *Willems* establishes a dangerous precedent for undermining arbitration provisions nationally 3

III. The Montana Supreme Court's imposed requirement that broker-dealers explain arbitration clauses to customers before the customers sign an account agreement violates the FAA and threatens to upset the entire securities industry by imposing Montana only rules on SEC approved arbitration language used in standardized securities agreements nationwide 4

CONCLUSION 9

TABLE OF AUTHORITIES

Page

CASES

ABM Farms, Inc. v. Woods, 692 N.E.2d 574 (Ohio 1998) 6

Barrett v. McDonald Investments, Inc., 870 A.2d 146 (Me. 2005) 3

Chor v. Piper, Jaffray & Hopwood, Inc., 862 P.2d 26 (Mont. 1993) 6

Casarotto v. Lombardi, 886 P.2d 931 (Mont. 1994) 4

Casarotto v. Lombardi, 901 P.2d 596 (Mont. 1995) ... 4, 5, 6, 9

Dinsmore v. Piper Jaffray, 593 N.W.2d 41 (S.D. 1999) 6

Doctor's Associates, Inc. v. Casarotto, 515 U.S. 1129 (1995) 4

Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996) 1, 4

Jones v. Merrill Lynch, Pierce, Fenner & Smith, 604 So.2d 332 (Ala. 1991) 6

Kloss v. Edward D. Jones, (Kloss I), 2002 MT 129, 54 P.3d 1, *cert. denied*, 583 U.S. 956 (2003) 7

Kloss v. Edward D. Jones (Kloss II), 2002 MT 129A, 57 P.3d 41, *cert. denied*, 538 U.S. 946 (2003) 7

Mueske v. Piper Jaffray & Hopwood, Inc., 859 P.2d 444 (Mont. 1993) 5

Perry v. Thomas, 482 U.S. 483 (1987) 1, 5, 6

Rosenthal v. Great Western Financial Securities Corp., 926 P.2d 1061 (Cal. 1996) 6

Willems v. U.S. Bancorp Piper Jaffray Inc., et al., 2005 MT 37, 107 P.3d 465 ..... 1, 2, 3, 7

TABLE OF AUTHORITIES – Continued

Page

OTHER AUTHORITIES

Sup. Ct. R. 15.2 4

NASD Manual, Rule 3110(f) 7

Scott J. Burnham, *The War Against Arbitration in Montana*, 66 Mont. L. Rev. 139 (2005) 9

INTRODUCTION

Petitioners seek this Court's review to ensure State and Federal Courts uniformly apply the Federal Arbitration Act ("FAA") to arbitration provisions in securities customer agreements. Only then will the Montana courts enforce arbitration provisions in a manner consistent with the Federal Arbitration Act, this Court's precedent and well-settled federal law. Absent intervention by this Court, arbitration provisions contained in securities customer agreements and other industry standard agreements used throughout the United States may be unenforceable in Montana.

Contrary to Respondents' argument, this case is not about the Montana Supreme Court applying state law concerning fiduciary duty. This Court has previously stated that a State cannot create a state law applicable only to arbitration. *Doctor's Associates Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (*citing Allied-BruceTerminix Cos. v. Dobson*, 513 U.S. 265, 281 and *Perry v. Thomas*, 482 U.S. 483, 492, n. 9 (1987)). Yet, that is precisely what the Montana Supreme Court has done here.

The Montana Supreme Court's holding that a broker dealer has a fiduciary duty to explain an arbitration clause, but no other contract provision to a prospective client, *before* the client signs the contract containing the arbitration clause impermissibly singles out arbitration in violation of the Federal Arbitration Act. The Montana Supreme Court's decision is also contrary to decisions of the Supreme Courts of Alabama, California, Ohio and South Dakota. This Court chastised the Montana Supreme Court for precisely such action in *Casarotto*, but the Montana Supreme Court seems determined to ignore that admonishment and continue its misguided course.

Also, despite Respondents' claim to the contrary, Petitioners raised this federal question to the Montana Supreme Court and that Court specifically held that the Federal Arbitration Act was not violated. *Willems*, ¶¶ 26, 27 (App. 47-48).

The Montana Supreme Court's holding also wholly invalidates pre-dispute arbitration provisions in standardized brokerage agreements in Montana. This position is consistent with the Supreme Judicial Court of Maine but is inconsistent with three U.S. Courts of Appeals and sixteen State Supreme Courts which uniformly enforce pre-dispute arbitration provisions in securities customer agreements. By wholly invalidating pre-dispute arbitration provisions, the Montana Supreme Court impairs the contract rights of broker dealers and their clients, thus placing an undue and substantial burden on interstate commerce in violation of the Commerce Clause.

I. The Montana Supreme Court addressed a federal question.

Contrary to Respondents' contention, the Montana Supreme Court addressed a federal question. Petitioners argued to the Montana Supreme Court that the Trial Court's ruling violated the FAA, and the Montana Supreme Court held that the FAA was not violated. *Willems*, ¶¶ 26, 27 (App. 47-48). The Montana Supreme Court's Order states:

> . . . Piper thus reasons that the District Court improperly relied on *Kloss* to create a 'special legal standard' regarding fiduciary duties applicable only to arbitration provisions and not to other contract provision, in violation of the Federal Arbitration Act (FAA) and United States Supreme Court precedent.
>
> ¶ 27 We conclude that the District Court created no new special legal standards but instead properly applied Montana case law by relying on *Kloss*.

Willems, ¶¶ 26, 27 (App. 47-48). Accordingly, Piper raised and the Montana Supreme Court addressed a federal question.

II. *Willems* establishes a dangerous precedent for undermining arbitration provisions nationally.

The Supreme Judicial Court of Maine recently cited the Montana case at issue here as one in a series of cases that will roll back the enforcement of pre-dispute arbitration laws, in contravention of established U.S. Supreme Court precedent. The Maine Court invalidated an arbitration clause in an agreement between a broker-dealer and customer and stated its decision was a "retreat from [its] previously broad presumption in favor of arbitration." *Barrett v. McDonald Investments, Inc.*, 870 A.2d 146, 151 (Me. 2005). The concurring opinion expanded on the Court's rationale and cited the *Willems* case in support of its retreat:

> The passage of time and events, particularly the increased use of contracts of adhesion containing mandatory arbitration clauses to avoid judicial enforcement of federal and state anti-discrimination and consumer protection laws, is leading many appellate courts to distinguish and *weaken the significance of these [U.S. Supreme Court] precedents* from an earlier time in the development of arbitration law. . . . *Willems v. U.S. Bancorp Piper Jaffray, Inc.*, 2005 MT 37, ¶¶ 1, 27-28, 326 Mont. 103, 107 P.3d 465, 470 . . .

Barrett v. McDonald Investments, Inc., 870 A.2d 146, 153 (Me. 2005) (Alexander, J., concurring) (emphasis added). Absent this Court's intervention, more Courts will follow Montana's decision and, like the Supreme Judicial Court of Maine, will retreat from established U.S. Supreme Court precedent and invalidate arbitration clauses.

III. The Montana Supreme Court's imposed requirement that broker-dealers explain arbitration clauses to customers before the customers sign an account agreement violates the FAA and threatens to upset the entire securities industry by imposing Montana only rules on SEC approved arbitration language used in standardized securities agreements nationwide.

What is most telling about Respondents' Brief in Opposition is what it does not say. Supreme Court Rule 15.2 provides Respondents have an obligation to point out in their Brief in Opposition any perceived misstatements of fact or law in the Petition, otherwise the objection may be deemed waived. Sup. Ct. R. 15.2. Respondents did not identify any perceived misstatements of law or fact in response to Petitioners' Petition.

With respect to Petitioners' first argument, Respondents do not dispute that the Montana Supreme Court held the *only* contract provision the broker had a fiduciary duty to explain was the arbitration provision. Respondents instead argue this holding does not single out arbitration clauses, but is consistent with Montana's fiduciary duty of "full disclosure." Resp'ts' Opp'n at p. 7. Full disclosure, however, would require the broker to explain *every* provision, not just the arbitration provision.

Further, Respondents offer no response to Petitioners' description of Montana's historical hostility toward arbitration. Respondents fail to come to grips with the fact that the instant rulings are fundamentally no different than the Montana Supreme Court's rulings in the *Casarotto* series of cases,[1] in which this Court struck down

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[1] *Doctor's Associates, Inc. v. Casarotto*, 515 U.S. 1129 (1995); *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996); *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994); *Casarotto v. Lombardi*, 901 P.2d 596 (Mont. 1995).

a Montana statute which treated arbitration clauses differently than any other contract provision.

It is no wonder Respondents made the tactical decision to ignore the fundamental holding in *Casarotto* because it is apparent from the Brief in Opposition they either misapprehend or misstated the meaning of the express language of the FAA and the previous decisions of this Court interpreting the FAA, including most notably *Perry v. Thomas*, 482 U.S. 483 (1987). In *Perry*, this Court specifically admonished that courts may not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot." *Perry, supra*, at 492, n. 9.

Respondents further ignore in the first instance that the FAA limits the application of state law to only that law providing for revocation of the contract generally. *Id.* Respondents also ignore the fact that the Montana Supreme Court has not found that sufficient grounds exist for the revocation of the customer agreements at issue here on the basis of fraud, fraudulent inducement, mutual mistake, or any other of the grounds generally applicable in state contract law. Rather, the Montana Court singled out the arbitration provision alone for invalidation and otherwise left the contracts in place and enforceable. Moreover, Respondents never alleged the agreements here were entered into fraudulently.

The ruling of the Montana Court created an impossible burden for any broker dealer to meet by requiring a nebulous affirmative obligation to disclose and explain the arbitration provision, and only the arbitration provision, in a level of detail which inexplicably goes beyond the written disclosure which is already found in the contracts at issue and which complies with the Montana Court's own earlier requirement enunciated in *Mueske v. Piper Jaffray & Hopwood, Inc.*, 859 P.2d 444 (Mont. 1993). In so doing, the Montana Supreme Court has impermissibly imposed a burden which is incapable of determination or satisfaction,

and significantly greater than the legislatively created burden that was found unacceptable in *Casarotto*. Simply put, the Montana Court has impermissibly singled out arbitration clauses in a way which this Court has already rejected. The Montana Supreme Court must heed the admonishment of both *Casarotto* and *Perry*: that it may not do what the legislature cannot.

Respondents concede a fiduciary duty between an investment advisor and his or her client does not exist absent a grant of discretionary authority, but do not address Petitioners' argument that a fiduciary duty created by an agreement cannot exist *before* the agreement creating the duty is signed. Resp'ts' Opp'n at p. 7; (*citing Chor v. Piper Jaffray & Hopwood Inc.*, 862 P.2d 26, 32 (1993)). The Montana Supreme Court's creation of such a preexisting fiduciary duty merely serves to meet its desire to strike down pre-dispute arbitration clauses.

Respondents also fail to address the decisions of four State Supreme Courts that are in direct conflict with the Montana Supreme Court's decision at issue here. These Courts found that a broker does not have a fiduciary duty to explain an arbitration provision to a customer. *Dinsmore v. Piper Jaffray*, 593 N.W.2d 41 (S.D. 1999) (finding fiduciary duties are not owed when parties are dealing at arm's length; Piper Jaffray acts on its own behalf when negotiating and executing account agreements); *Rosenthal v. Great Western Financial Securities Corp.*, 926 P.2d 1061 (Cal. 1996) (finding fiduciary duties of a broker do not extend to orally alerting the customer to the existence of an arbitration clause or explaining its meaning and effect); *Jones v. Merrill Lynch, Pierce, Fenner & Smith*, 604 So.2d 332 (Ala. 1991) (finding absence of explanation by broker dealer of arbitration agreement to customer does not constitute a breach of a fiduciary duty); *ABM Farms, Inc. v. Woods*, 692 N.E.2d 574 (Ohio 1998) (finding law did not require broker dealer to explain arbitration provision, or any other aspect of contract to party prior to signing).

Respondents also repeatedly misstate the Montana Supreme Court's findings. Respondents incorrectly state the Montana Supreme Court held Petitioners had a fiduciary duty to explain Piper's policy permitting clients to cross out the arbitration provision. Resp'ts' Opp'n at pp. 7-8, 10. The Montana Supreme Court, however, did not find Piper had a fiduciary duty to explain the opt-out policy. It only found Piper had a duty to explain the arbitration provision. *Willems* ¶ 28 (App. 34) ("We affirm the District Court's conclusion that Piper owed a fiduciary duty to explain the arbitration provision to Willems. . . .")

Respondents fail to explain how the Montana Supreme Court's reference to *Kloss* is a proper application of state law when the facts in *Kloss* are significantly different than those here. *Kloss v. Edward D. Jones*, 2002 MT 129, 310 Mont. 123, 54 P.3d 1, *cert. denied*, 538 U.S. 956 (2003) ("*Kloss I*"); *see also*, *Kloss v. Edward D. Jones*, 2002 MT 129A, 57 P.3d 41, *cert. denied*, 538 U.S. 956 (2003) ("*Kloss II*").

In *Kloss*, when Mrs. Kloss opened account at issue, she did not sign the account agreement, but instead signed a detachable card acknowledging she received a copy of the agreement and incorporating an arbitration clause by reference. *Kloss I* at 126, 54 P.3d at 4. In contrast, here, the agreements signed by the customers contained the arbitration provisions, and also contained a thorough explanation of arbitration in the language of the arbitration provisions themselves. (App. 63-64). This language was approved and mandated by the U.S. Securities and Exchange Commission ("SEC"). Rule 3110(f) National Association of Securities Dealers ("NASD") Manual. Thus, to the extent any explanation of the arbitration clause was needed, it was provided in a manner consistent with the requirements of the SEC and NASD.

With respect to Petitioners' second argument, Respondents provide no justification for Montana's refusal to enforce pre-dispute arbitration agreements in securities contracts when three U.S. Courts of Appeals and Sixteen State Supreme Courts uniformly enforce these arbitration agreements. In two sentences, Respondents dismiss these contrary decisions by stating these decisions have nothing to do with the basis of the Montana Supreme Court's decision. Resp'ts' Opp'n at p. 9. Not only is this explanation vague and meaningless, but it is also contrary to the numerous cases listed on pages 25-26 of the Petition.

With respect to Petitioners' third argument, Respondents do not dispute that the Montana Supreme Court's decisions will impair the Petitioners' and other broker-dealers' ability to rely upon uniform agreements drafted in compliance with SEC regulations when executed in Montana by Montana clients. Respondents also do not challenge Petitioners' arguments that the Montana Supreme Court's decisions violate the Commerce Clause because they will place an undue and substantial burden on interstate commerce by impairing Petitioners' right to contract in Montana.